

STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC

Material for

*Staff Presentation to the
Federal Open Market Committee*

July 5, 1989

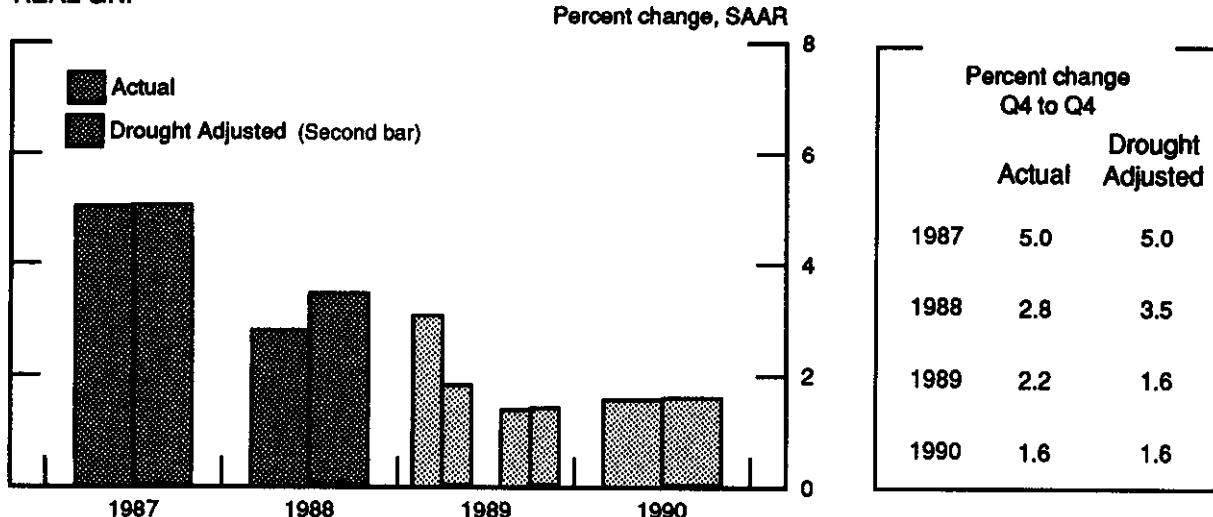
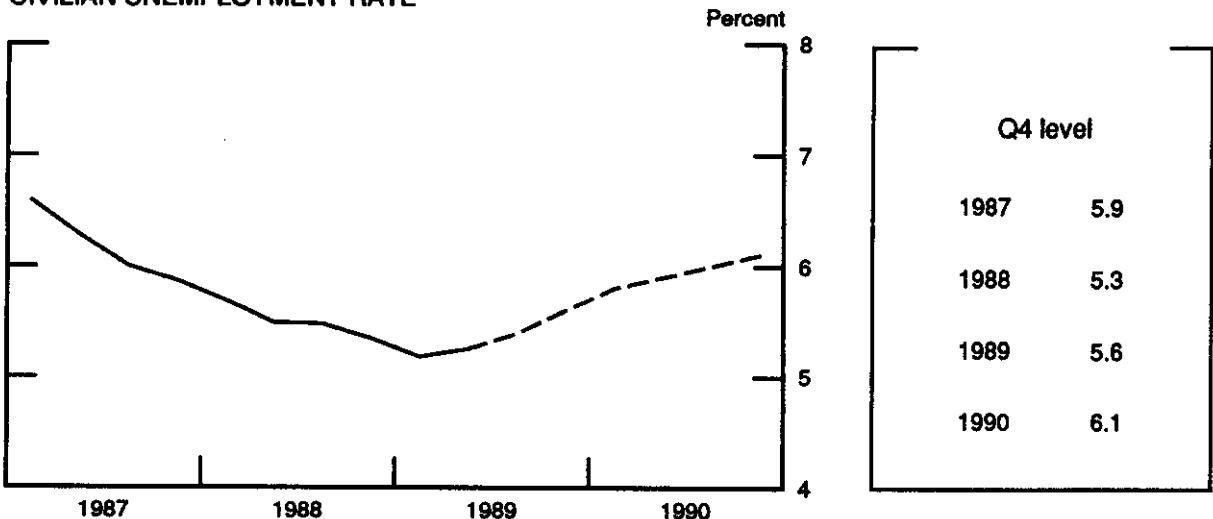
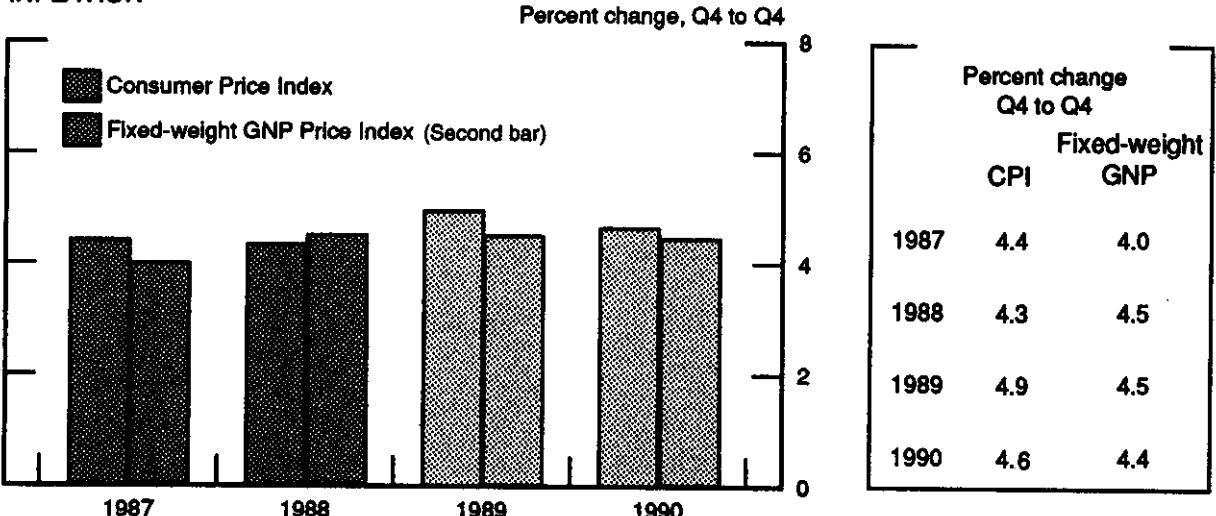
Basic Assumptions

- Federal Reserve will seek to bring about a gradual reduction in the underlying rate of inflation.
- Fiscal policy will remain moderately restrictive.
- Crop yields will be normal.
- Crude oil prices will fall somewhat from current levels.

Financial Projections

- Interest rates will change little through 1990.
- M2 will grow around 4 percent in 1989 and 6 1/2 percent in 1990.
- The dollar will depreciate moderately.

Chart 2

REAL GNP**CIVILIAN UNEMPLOYMENT RATE****INFLATION**

ECONOMIC PROJECTIONS FOR 1989

FOMC				
	Range	Central Tendency	Administration	Staff
----- <i>Percent change, Q4 to Q4</i> -----				
Nominal GNP	5 to 7 3/4	6 to 7 1/4	?	6.4
<i>previous estimate</i>	5 1/2 to 8 1/2	6 1/2 to 7 1/2	7.4	7.1
Real GNP	1 1/2 to 3	1 1/2 to 2 1/2	2.9 to 3.2	2.2
<i>previous estimate</i>	1 1/2 to 3 1/4	2 1/2 to 3	3.5	3.0
CPI	4 1/2 to 6	5 to 5 1/2	?	4.9
<i>previous estimate</i>	3 1/2 to 5 1/4	4 1/2 to 5	3.6	4.9
----- <i>Average level, Q4, percent</i> -----				
Unemployment Rate	5 to 6	5 1/4 to 5 3/4	?	5.6
<i>previous estimate</i>	5 to 6	5 1/4 to 5 1/2	5.2	5.5

ECONOMIC PROJECTIONS FOR 1990

FOMC				
	Range	Central Tendency	Administration	Staff
----- <i>Percent change, Q4 to Q4</i> -----				
Nominal GNP	4 1/4 to 8	5 1/2 to 6 3/4	?	6.0
Real GNP	1/2 to 2 1/2	1 to 2	?	1.6
CPI	3 to 6 1/4	4 to 5	?	4.6
----- <i>Average level, Q4, percent</i> -----				
Unemployment Rate	4 1/2 to 6 1/2	5 1/2 to 6	?	6.1

Chart 4

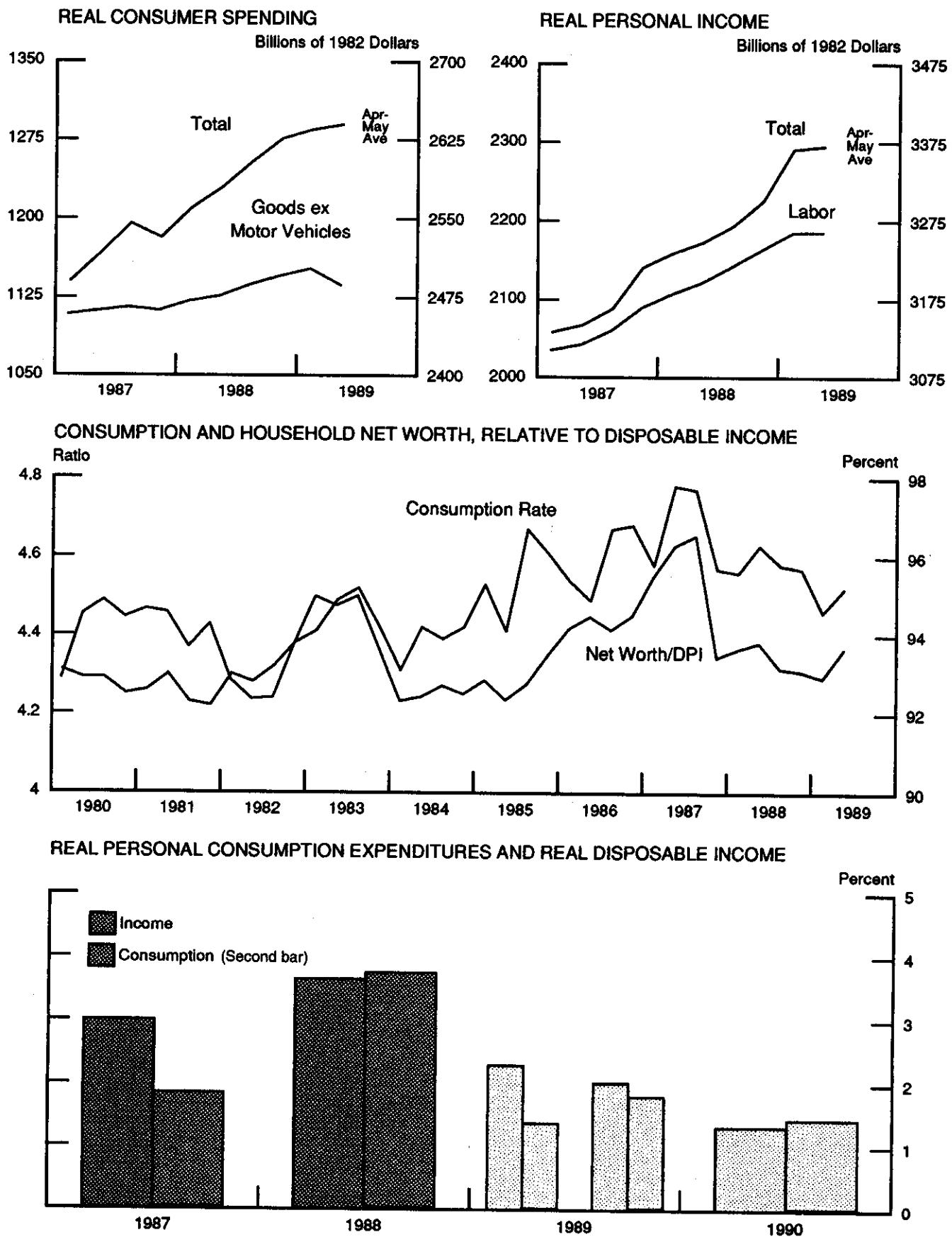
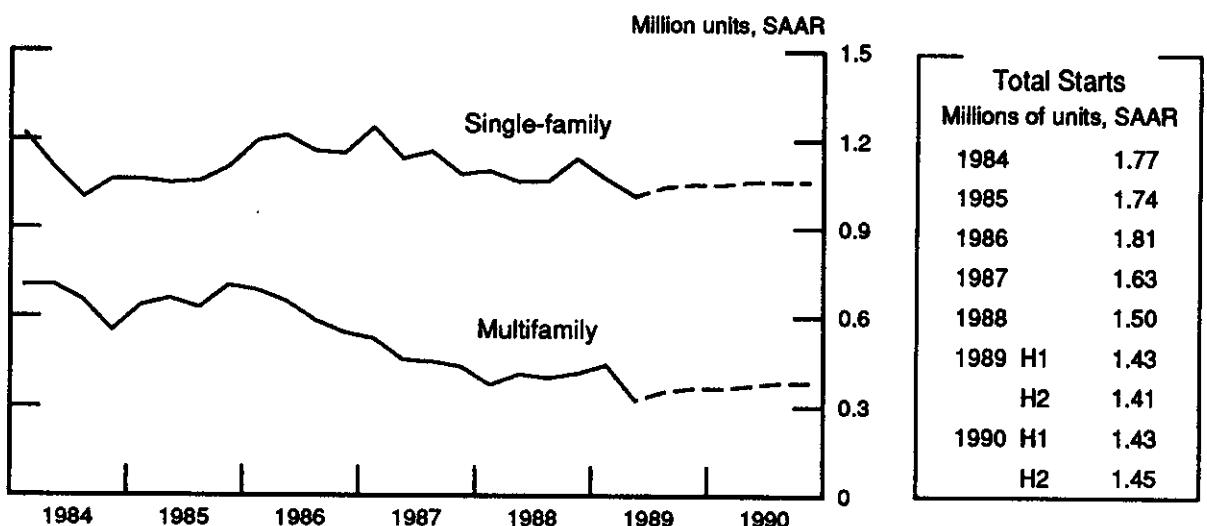
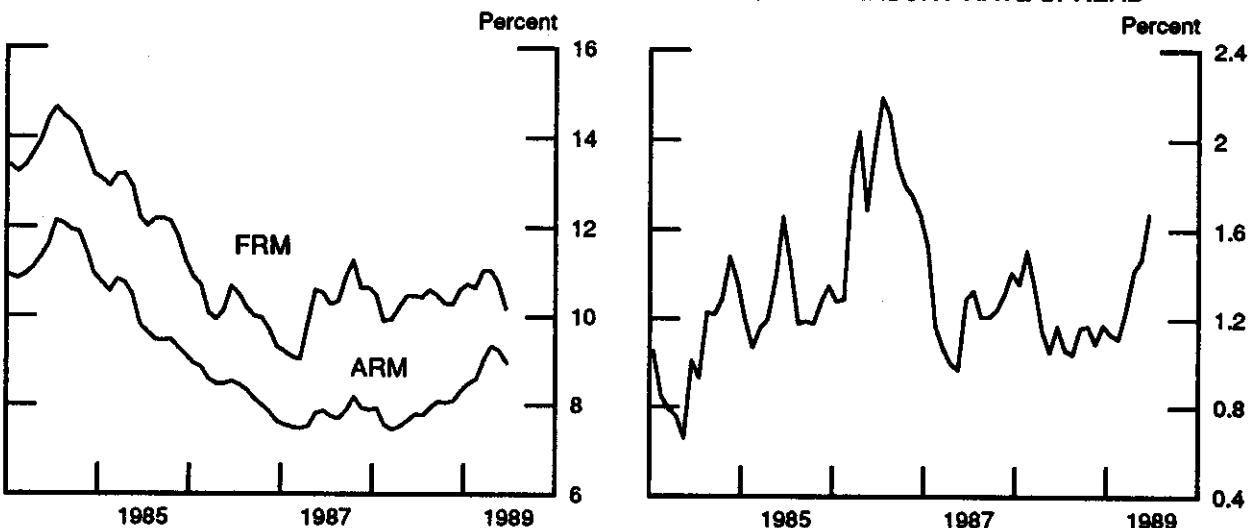


Chart 5

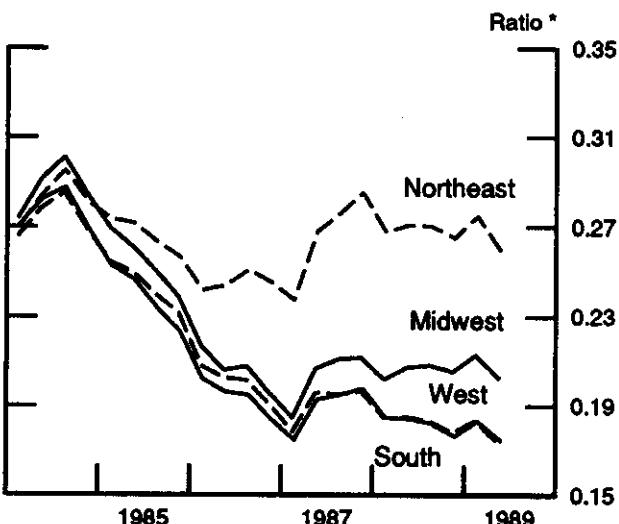
HOUSING STARTS



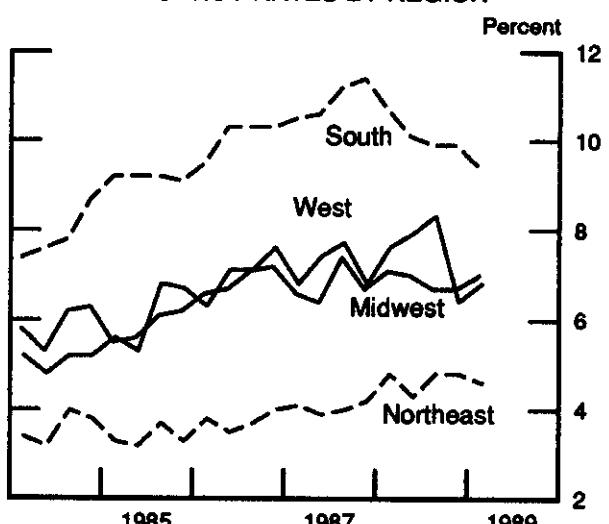
MORTGAGE RATES



MORTGAGE-SERVICING BURDEN

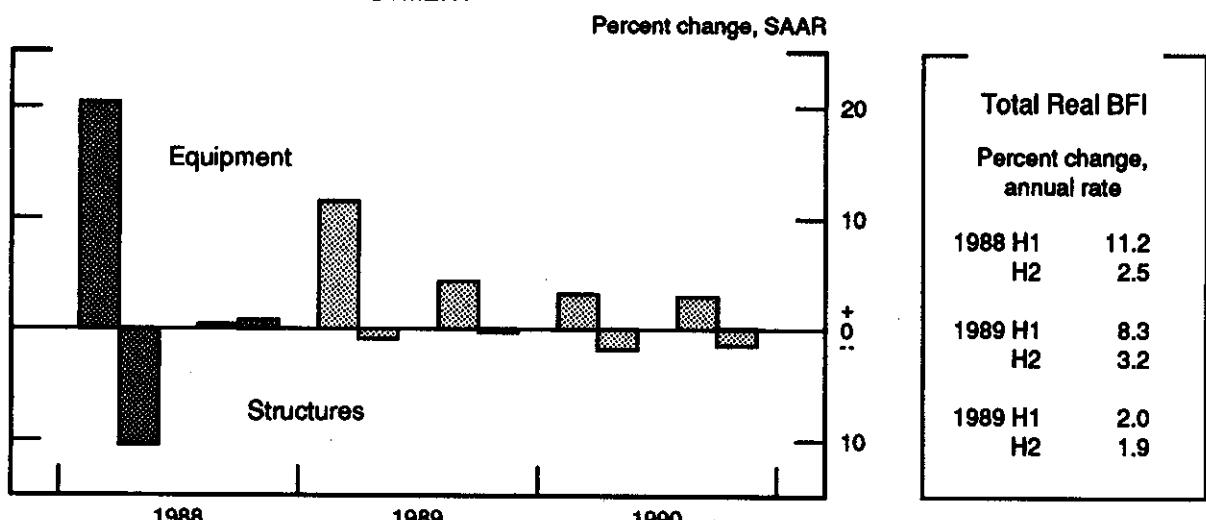


RENTAL VACANCY RATES BY REGION



* Monthly payment / income

Chart 6

REAL BUSINESS FIXED INVESTMENT**PLANT AND EQUIPMENT SPENDING**

	<u>1988 actual increase*</u>	<u>1989 planned increase</u>
Commerce Dept.	10.3%	9.9%
McGraw-Hill	10.3%	10.9%

*Commerce Survey

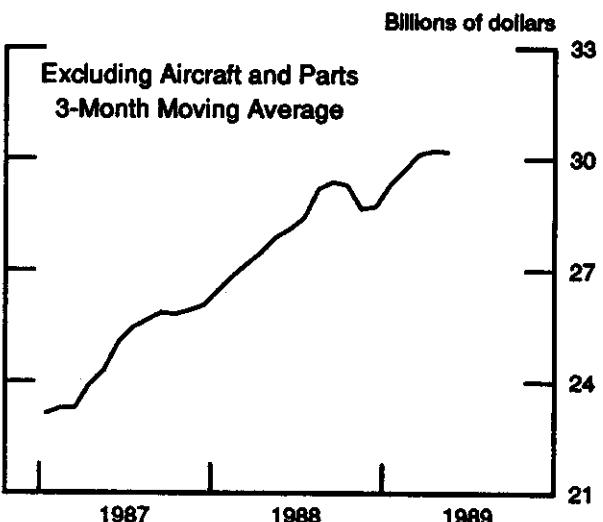
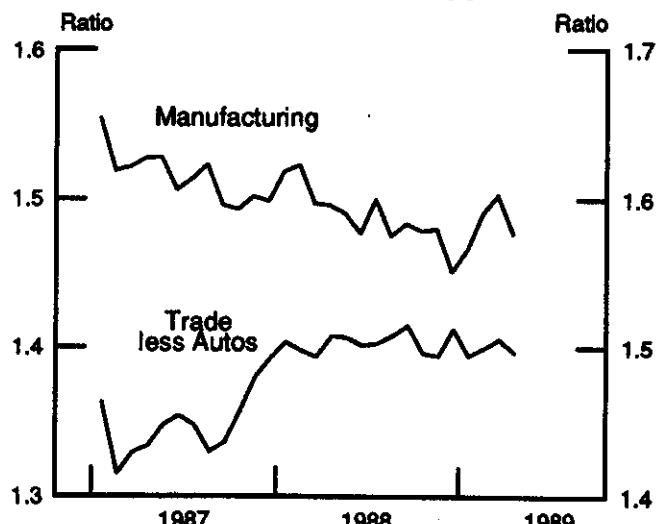
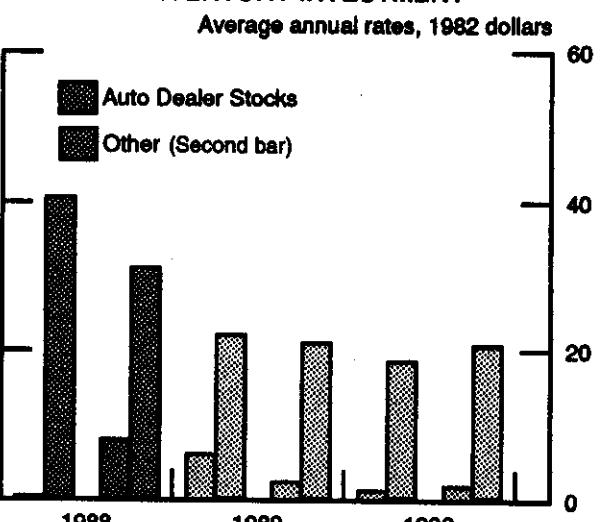
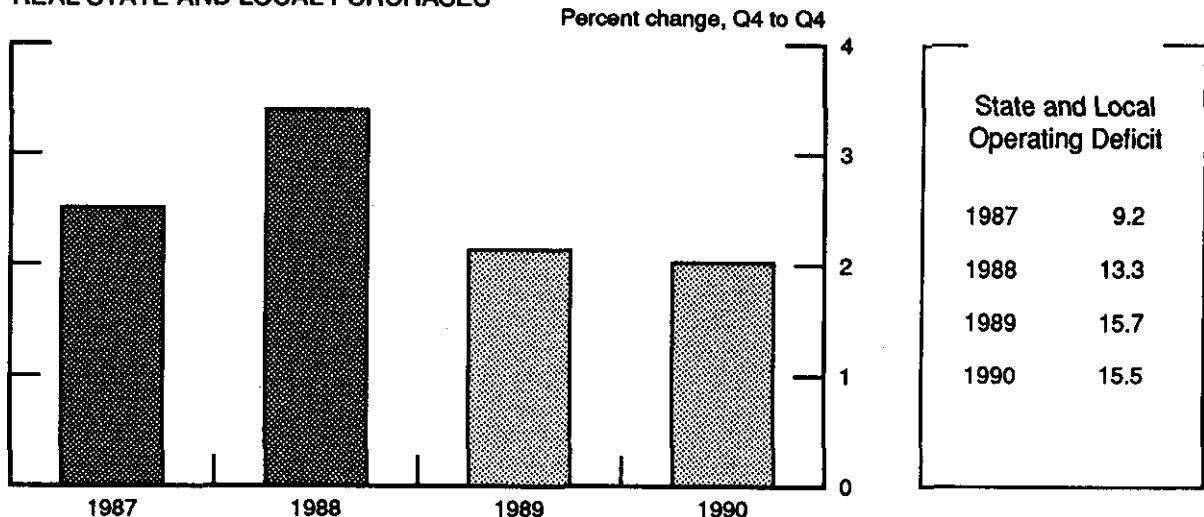
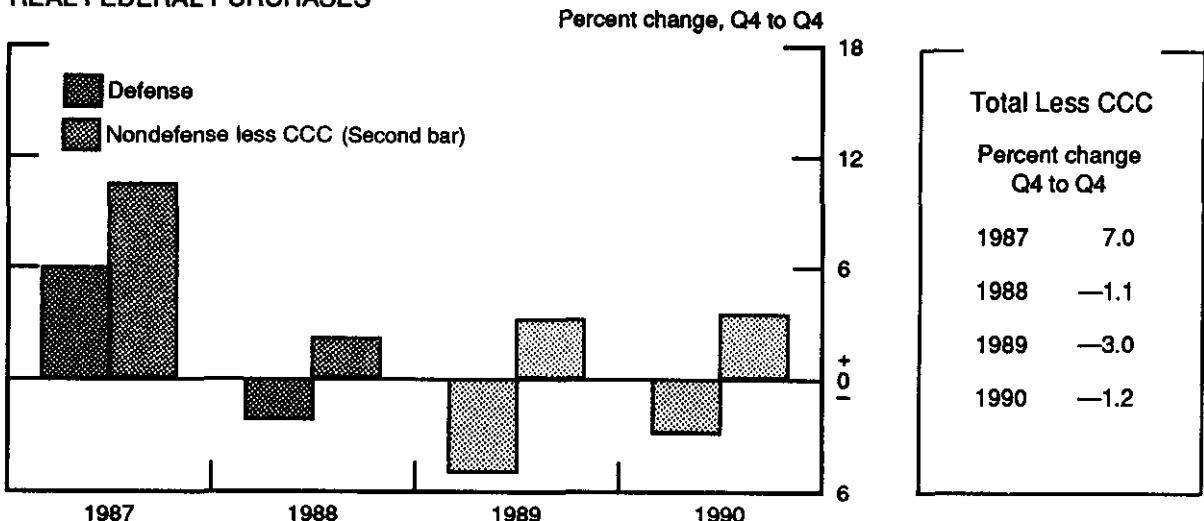
NONDEFENSE CAPITAL GOODS ORDERS**REAL INVENTORY-SALES RATIOS****NONFARM INVENTORY INVESTMENT**

Chart 7

REAL STATE AND LOCAL PURCHASES

State and Local Operating Deficit	
1987	9.2
1988	13.3
1989	15.7
1990	15.5

REAL FEDERAL PURCHASES

Total Less CCC	
Percent change Q4 to Q4	
1987	7.0
1988	-1.1
1989	-3.0
1990	-1.2

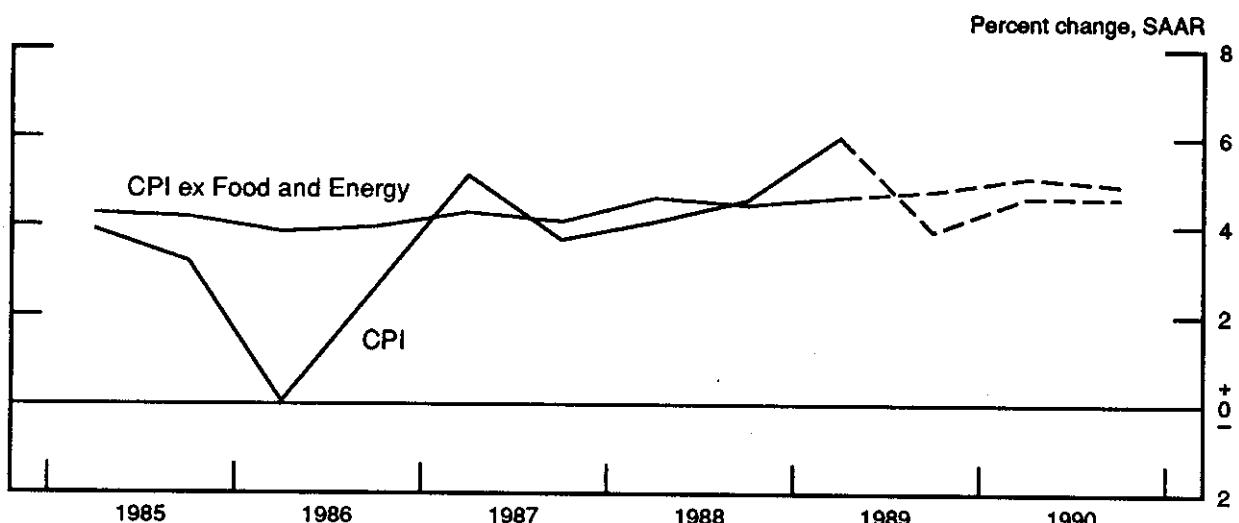
BUDGET SURPLUS/DEFICIT(—)

Billions of dollars	FY87	FY88	FY89	FY90
On Budget	-169	-194	-200	-177
Off Budget	20	39	52	68
Total	-150	-155	-148	-109
Memo: Fiscal Impetus*	2.3	2.1	-2.6	-7.4

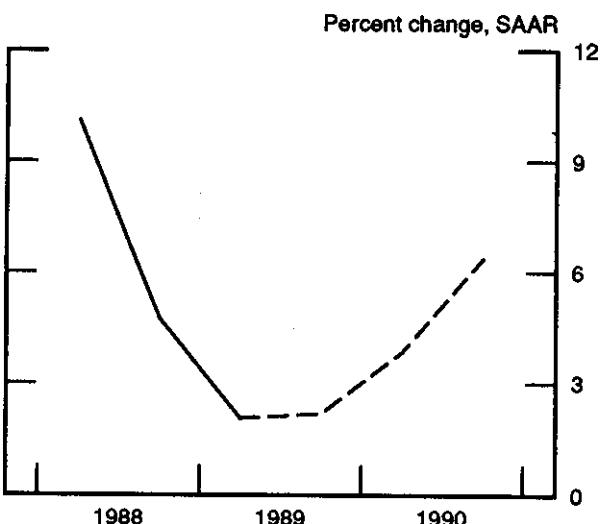
*Percent of Real Federal Purchases

Chart 8

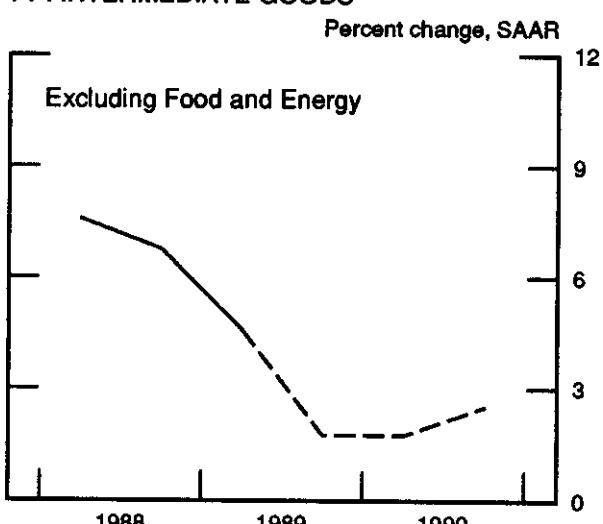
CONSUMER PRICE INFLATION



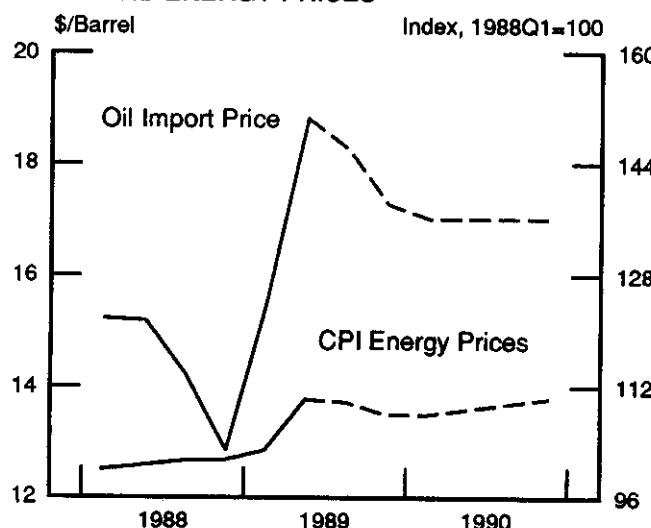
NON - OIL IMPORT PRICES



PPI INTERMEDIATE GOODS



OIL AND ENERGY PRICES



CPI FOOD PRICES

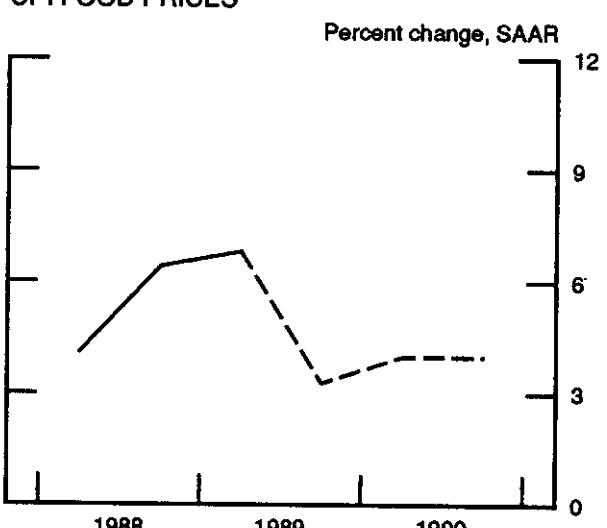
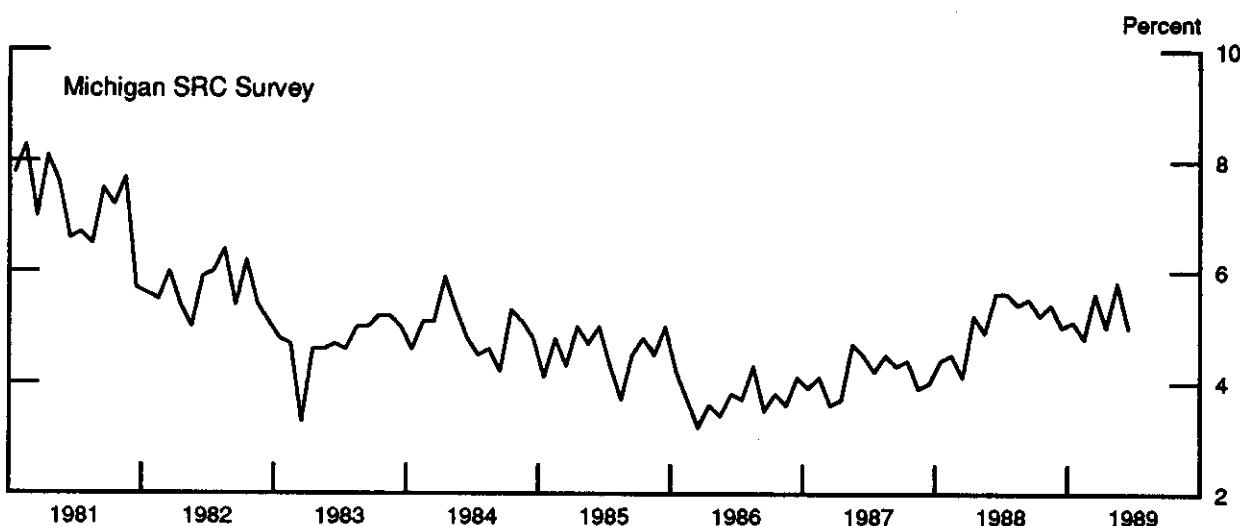
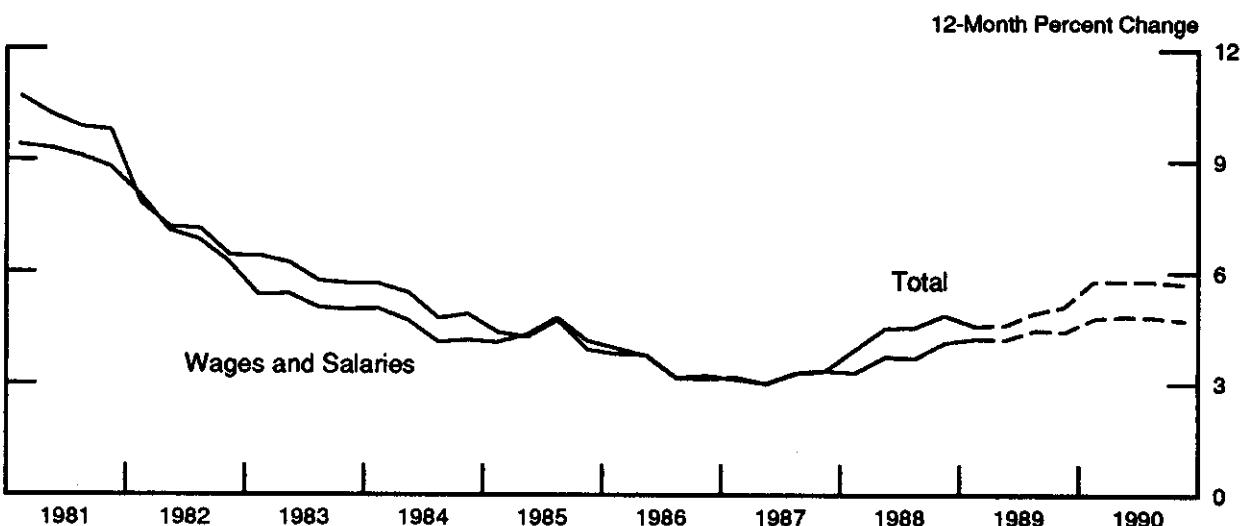


Chart 9

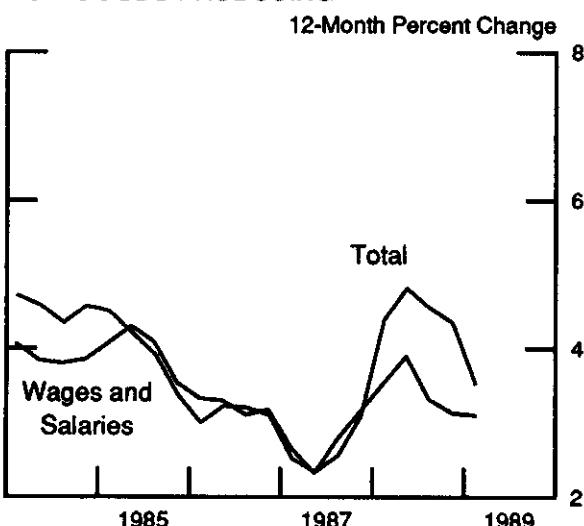
CONSUMER INFLATION EXPECTATIONS



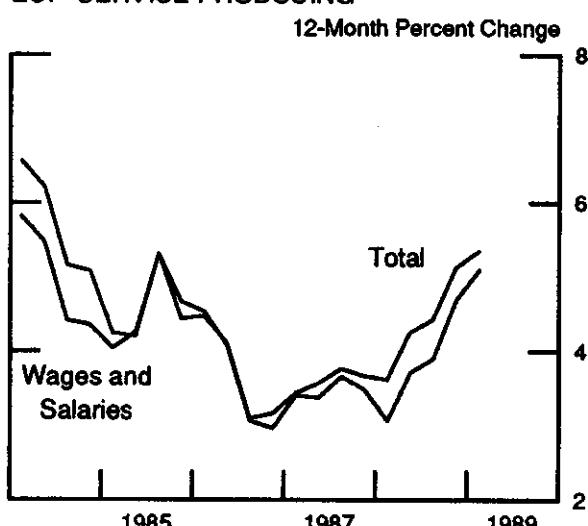
EMPLOYMENT COST INDEXES - PRIVATE INDUSTRY



ECI - GOODS PRODUCING



ECI - SERVICE PRODUCING



Alternative Forecasts

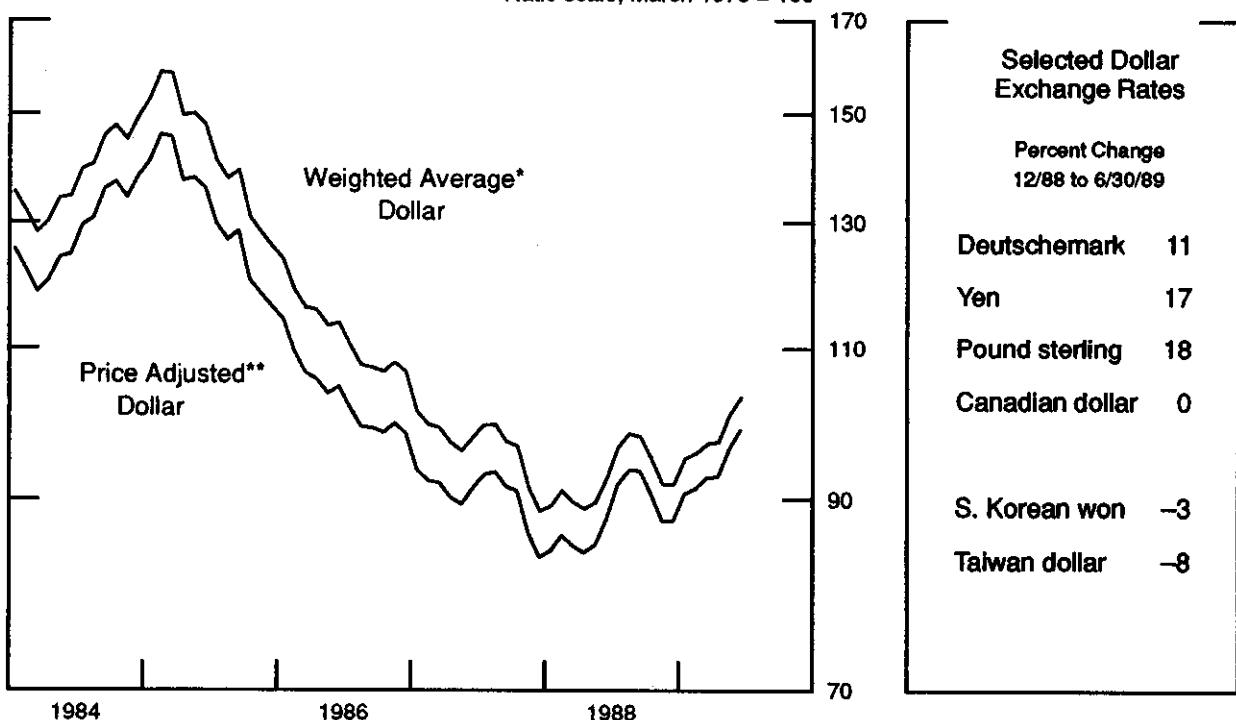
- Baseline:** Greenbook forecast extended through 1991, with assumption of \$25 billion FY 91 deficit reduction package and M2 growth of 7 percent in 1991.
- Less Inflation:** Less inflation pressure is associated with any level of resource utilization — equivalent to assuming 1/2 percent lower NAIRU than in Baseline. Same M2 path as in Baseline.
- More Inflation:** More inflation pressure is associated with any level of resource utilization — equivalent to assuming 1/2 percent higher NAIRU than in Baseline. Same M2 path as in Baseline.

	1989	1990	1991
Percent change, Q4 to Q4			
Real GNP			
Baseline	2.2	1.6	2.4
Less Inflation	2.1	1.8	2.9
More Inflation	2.3	1.4	1.9
GNP Prices			
Baseline	4.5	4.4	3.9
Less Inflation	4.4	3.9	3.1
More Inflation	4.6	4.9	4.6
Q4 level, percent			
Unemployment Rate			
Baseline	5.6	6.1	6.2
Less Inflation	5.6	6.1	6.0
More Inflation	5.6	6.1	6.4
Billions of dollars			
Budget Deficit			
Baseline	148	109	98
Less Inflation	148	108	89
More Inflation	148	111	108

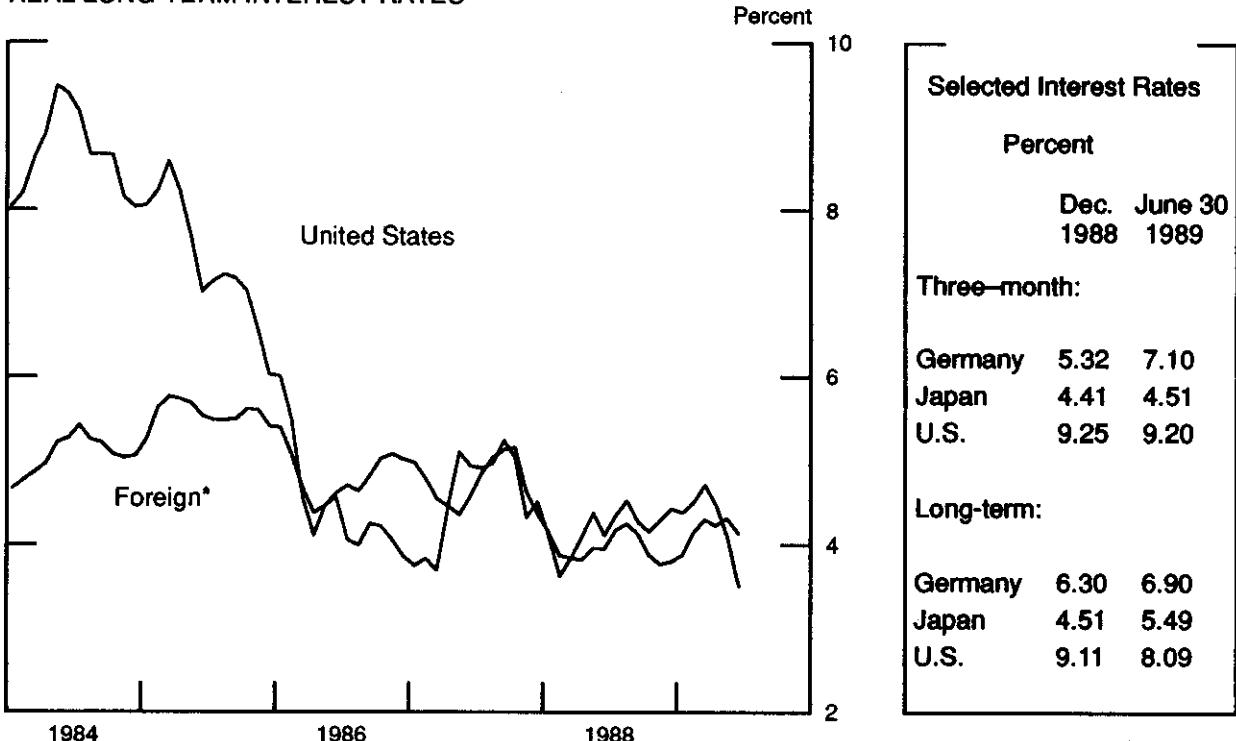
Chart 11

FOREIGN EXCHANGE VALUE OF THE U.S. DOLLAR

Ratio scale, March 1973 = 100



REAL LONG-TERM INTEREST RATES***



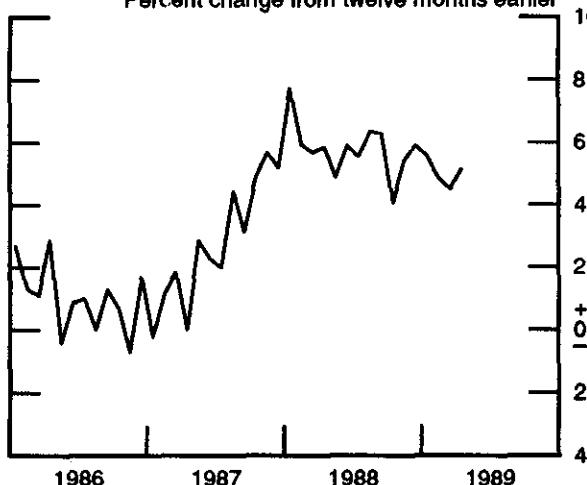
* Weighted average against or of foreign G-10 countries using total 1972-76 average trade.

** Adjusted by relative consumer prices.

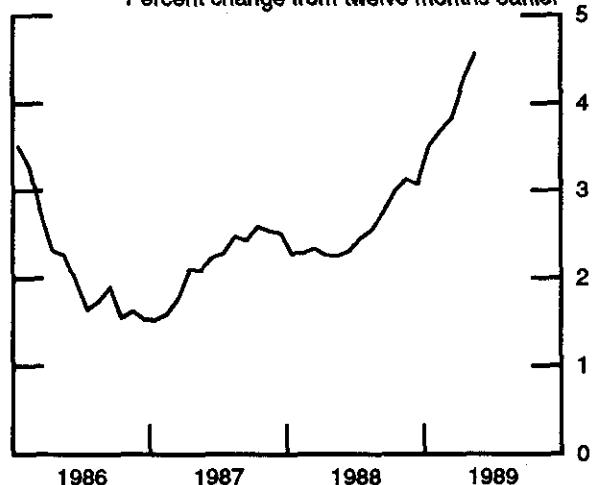
*** Multilateral trade-weighted average of long-term government or public authority bond rates adjusted for expected inflation estimated by a 36-month centered moving average of actual inflation (staff forecasts where needed).

Chart 12

INDUSTRIAL PRODUCTION ABROAD *
Percent change from twelve months earlier

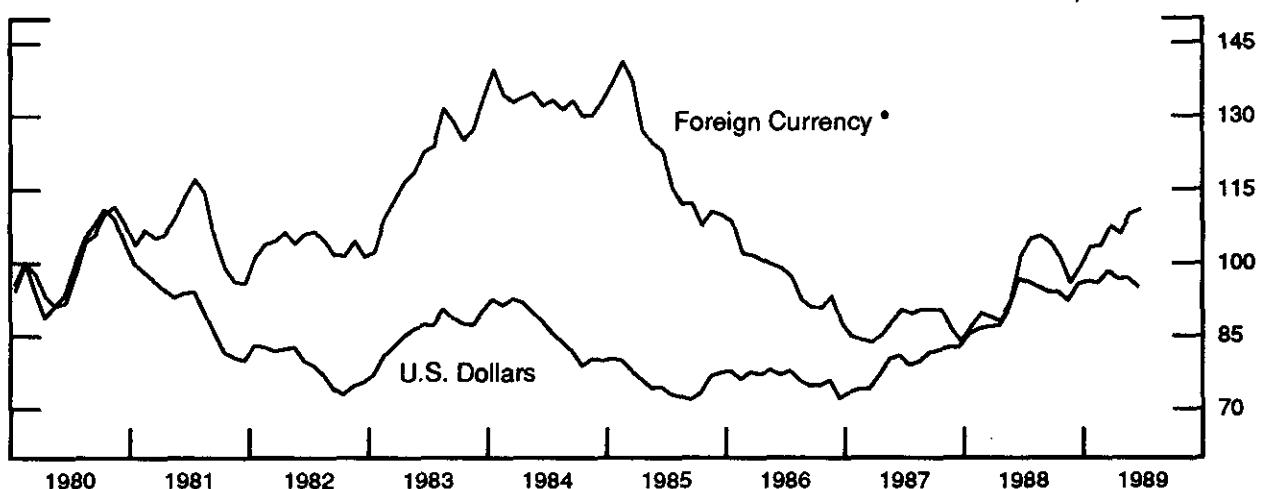


CONSUMER PRICES ABROAD *
Percent change from twelve months earlier



COMMODITY PRICES **

Index, 1980 = 100



ECONOMIC POLICY ABROAD

- Continued concern about inflation and capacity pressures
- Additional monetary tightening in 1989 in some countries, with gradual easing in 1990 as growth slows and inflation declines.
- Fiscal policy generally neutral, but tax reductions scheduled for Germany in 1990.

* Weighted average for the six major foreign industrial countries using 1982 GNP.

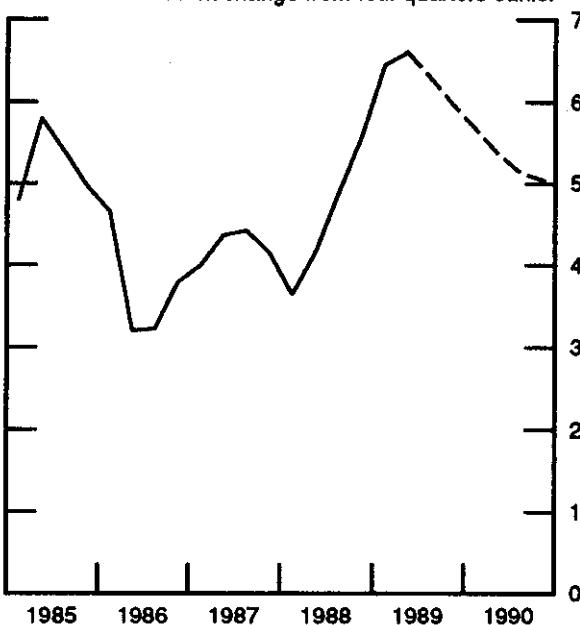
** Federal Reserve Board experimental index excluding crude oil.

Chart 13

Consumer Prices *

UNITED KINGDOM AND CANADA

Percent change from four quarters earlier



JAPAN, GERMANY, FRANCE, AND ITALY

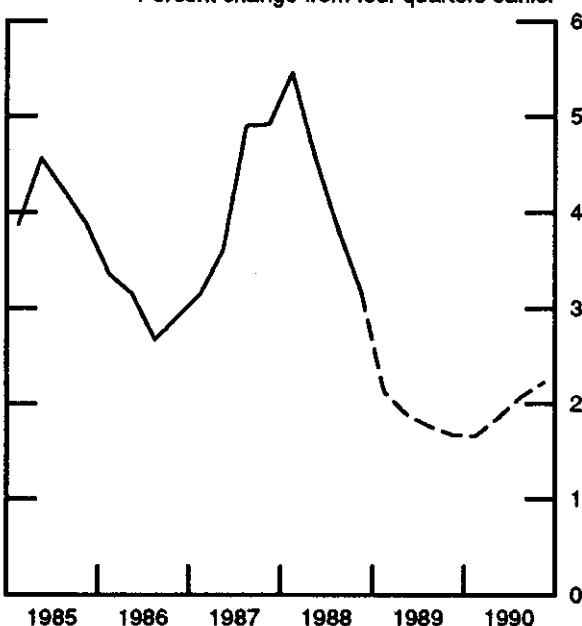
Percent change from four quarters earlier



Real GNP *

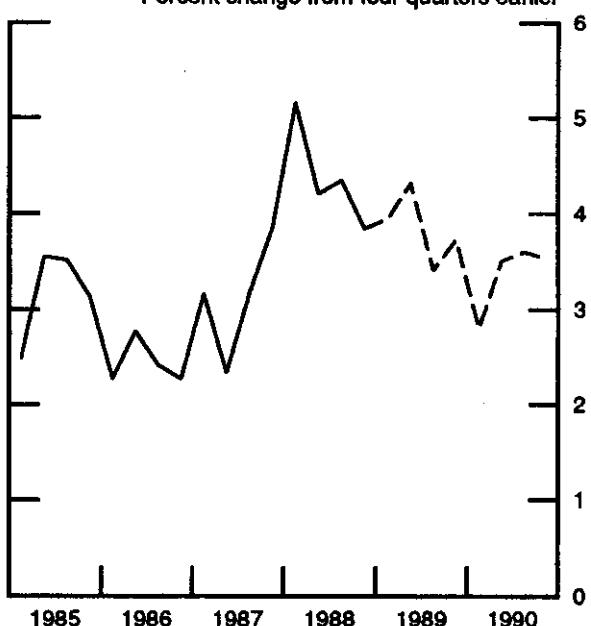
UNITED KINGDOM AND CANADA

Percent change from four quarters earlier



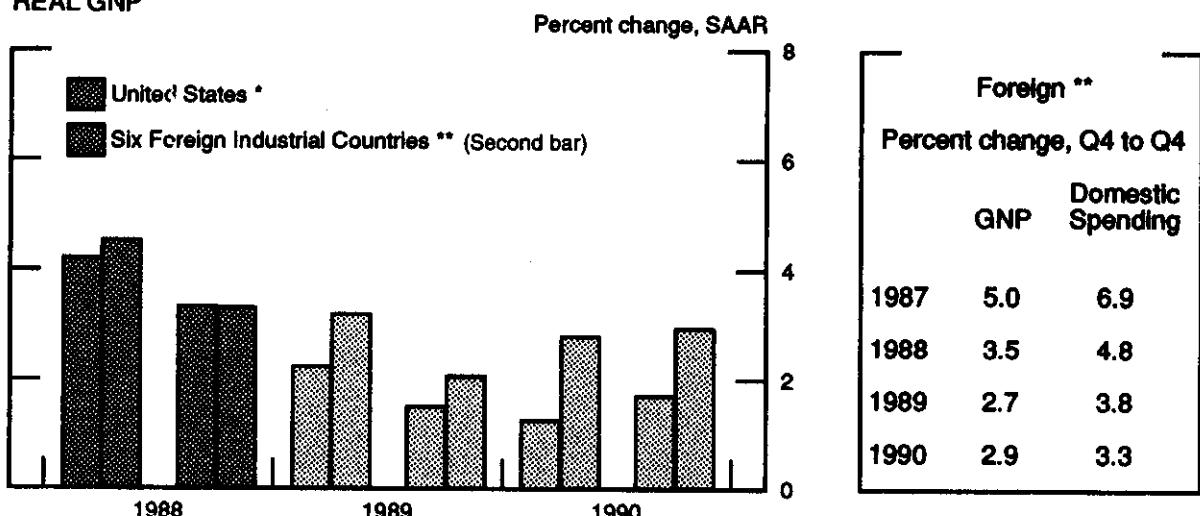
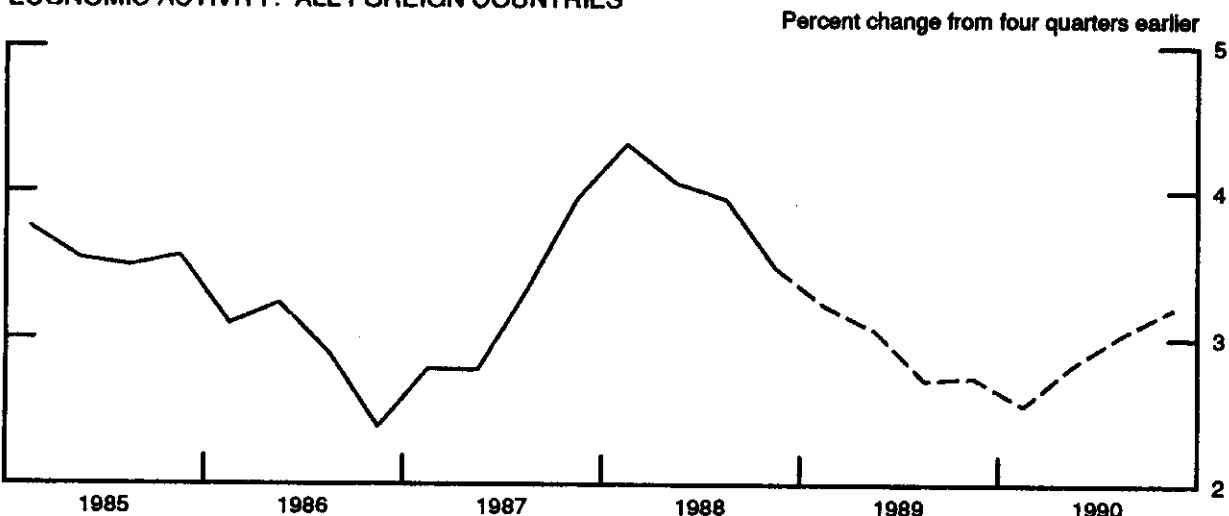
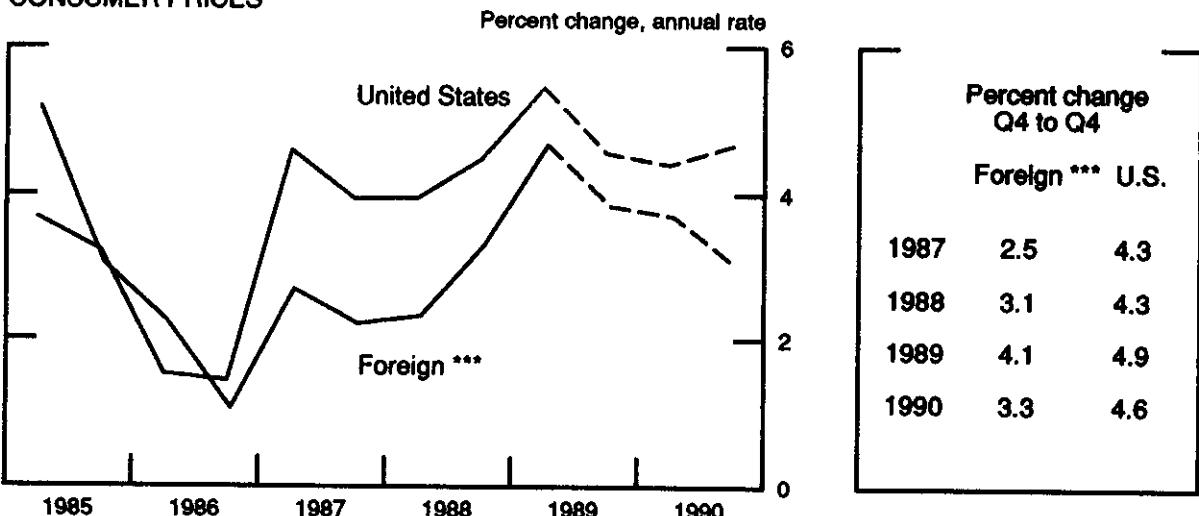
JAPAN, GERMANY, FRANCE, AND ITALY

Percent change from four quarters earlier



* Weighted average using 1982 GNP.

Chart 14

REAL GNP**ECONOMIC ACTIVITY: ALL FOREIGN COUNTRIES ******CONSUMER PRICES**

* Excludes drought effects.

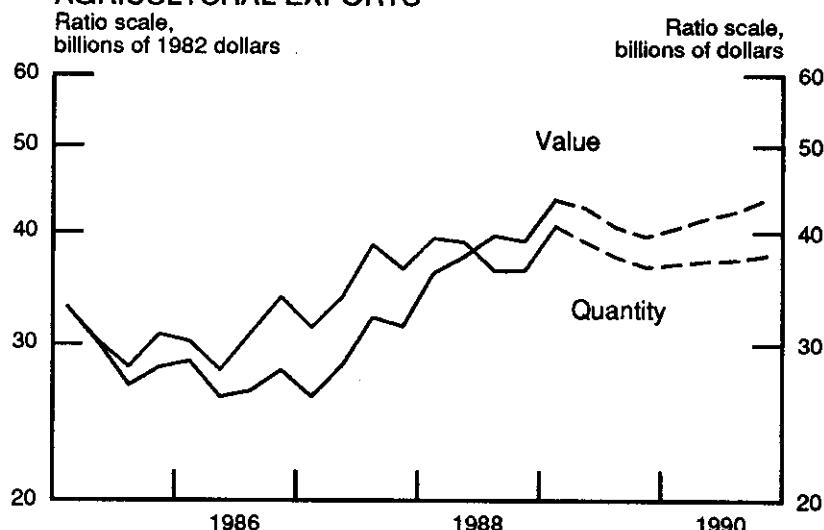
** Weighted average using U.S. non-agricultural exports, 1978-83.

*** Weighted average for the six major foreign industrial countries using 1982 GNP.

Foreign **	
	Percent change, Q4 to Q4
	GNP Domestic Spending
1987	5.0 6.9
1988	3.5 4.8
1989	2.7 3.8
1990	2.9 3.3

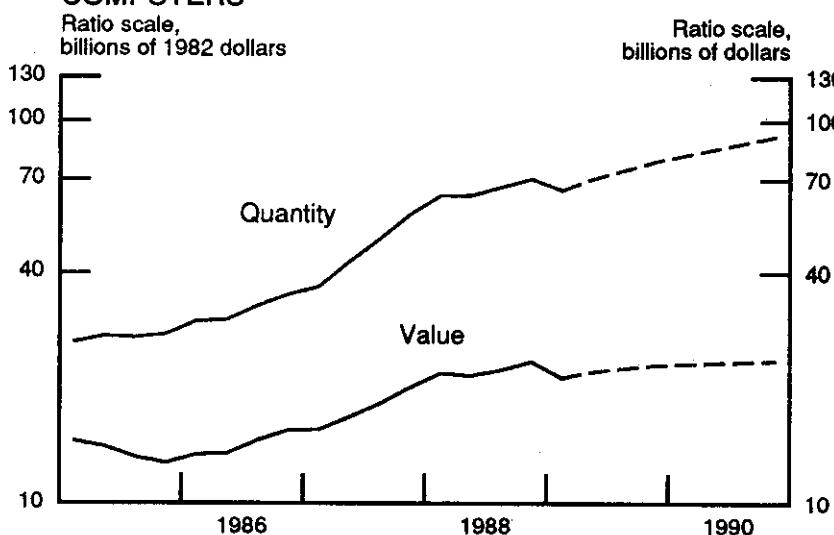
Chart 15

Exports

AGRICULTURAL EXPORTS**Percent Change
Q4 to Q4**

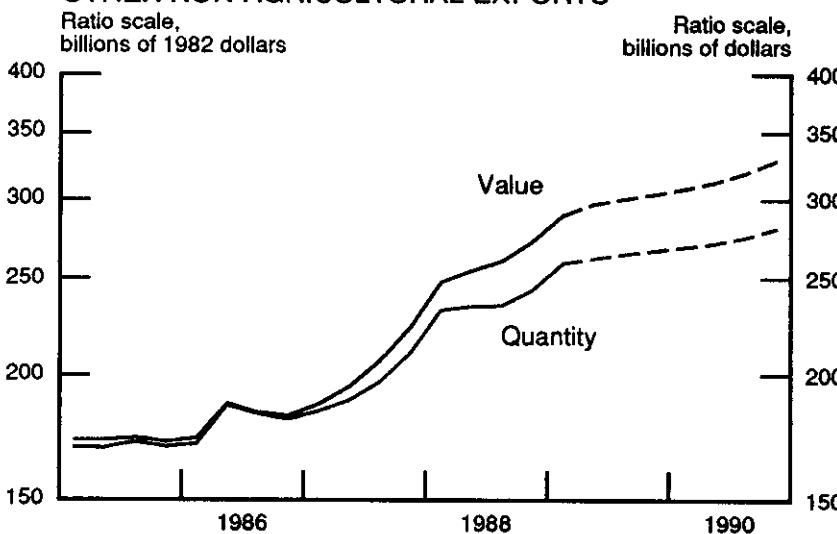
1988 1989 1990

Value	24	1	10
Price	25	0	7
1982\$	0	1	3

COMPUTERS**Percent Change
Q4 to Q4**

1988 1989 1990

Value	17	-2	3
Price	-6	-12	-12
1982\$	24	11	17

OTHER NON-AGRICULTURAL EXPORTS**Percent Change
Q4 to Q4**

1988 1989 1990

Value	22	12	8
Price	5	2	3
1982\$	16	10	5

Chart 16

Non-oil Imports

PRICES

Percent change, Q1 to Q1

1988 1989

1. Food	6	1
2. Industrial Supplies	17	10
3. Computers	-19	-6
4. Other Capital Goods	7	3
5. Automotive	5	4
6. Consumer Goods	9	3
7. Other	9	5
8. Total Non-oil	9	5

NIPA fixed-weight indexes

QUANTITIES

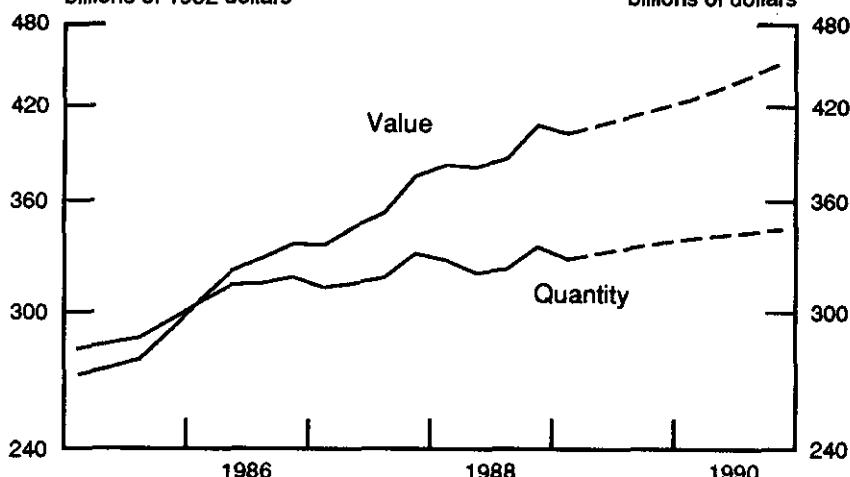
Percent change, Q1 to Q1

1988 1989

1. Food	1	-3
2. Industrial Supplies	1	-5
3. Computers	69	17
4. Other Capital Goods	16	9
5. Automotive	-1	1
6. Consumer Goods	1	2
7. Other	-2	-4
8. Total Non-oil	9	3

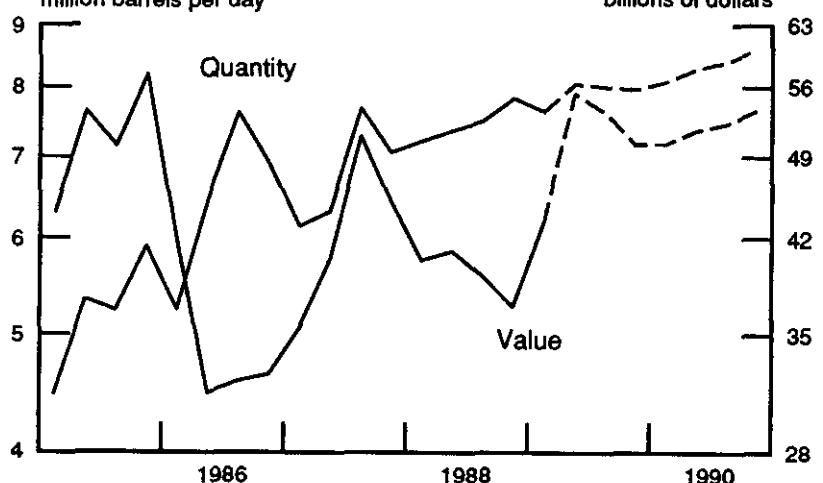
NIPA accounts.

NON-OIL IMPORTS*

Ratio scale,
billions of 1982 dollarsPercent Change
Q4 to Q4

	1988	1989	1990
Value	9	3	8
Price	7	2	5
1982\$	1	1	2

OIL

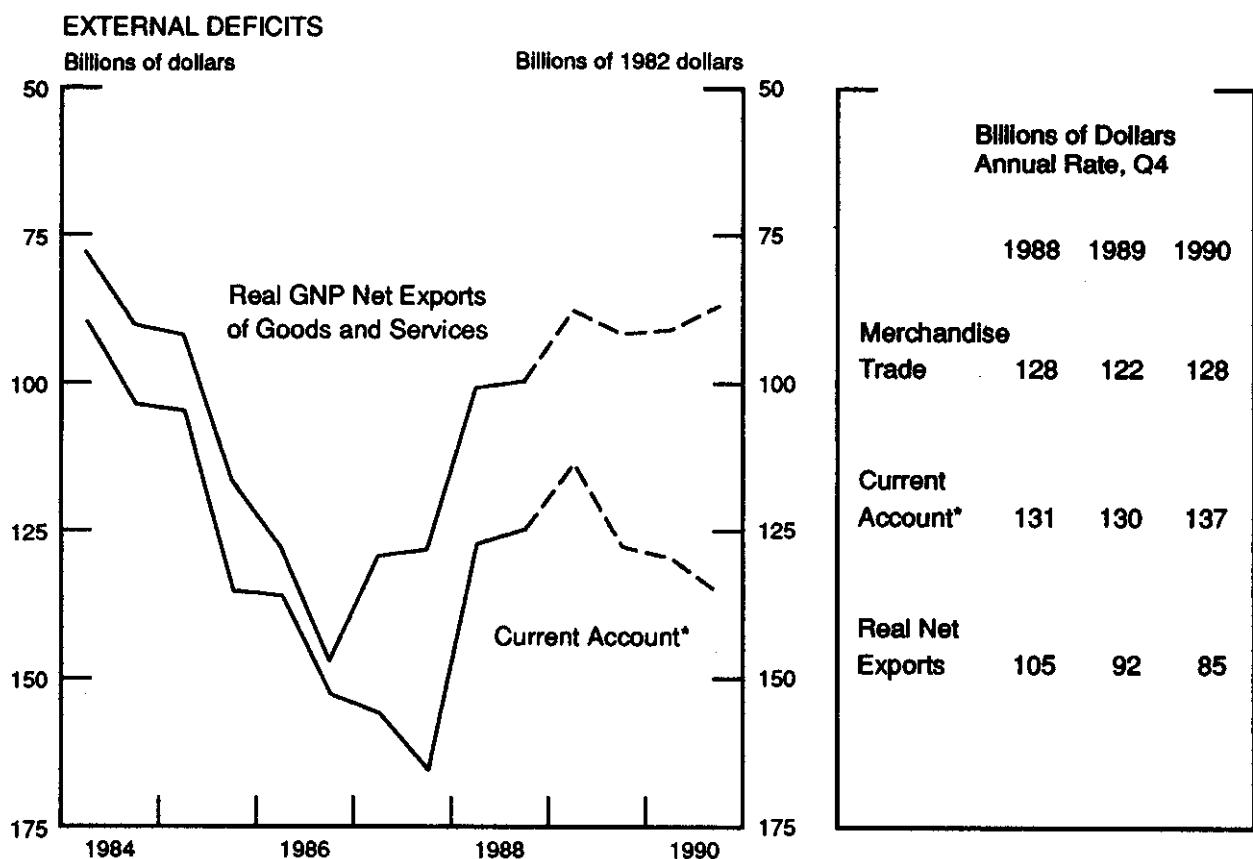
Ratio scale,
million barrels per dayRatio scale,
billions of dollarsPercent Change
Q4 to Q4

	1988	1989	1990
Value	-18	36	7
Price	-26	34	-1
1982\$	11	1	8

* Excluding computers.

Chart 17

U.S. External Accounts



U.S. INTERNATIONAL NET INVESTMENT POSITION

1981-1984 1985 1987 1989
Average

* Excluding capital gains and losses.

Alternative Forecast

- Baseline:** Greenbook forecast extended through 1991, with assumption of \$25 billion FY91 deficit reduction package and M2 growth of 7 percent in 1991.
- Unchanged Dollar:** Dollar remains at current level; M2 growth unchanged from baseline path.

	1989	1990	1991
Percent change, Q4 to Q4			
Real GNP, U.S.			
Baseline	2.2	1.6	2.4
Unchanged Dollar	2.2	1.3	1.9
GNP Prices			
Baseline	4.5	4.4	3.9
Unchanged Dollar	4.5	4.2	3.3
Real GNP Abroad*			
Baseline	2.7	2.7	2.5
Unchanged Dollar	2.7	3.0	3.3
Q4 level			
Current Account **			
Baseline	-130	-137	-135
Unchanged Dollar	-129	-138	-151

* Other G-10 countries.

** Excluding capital gains and losses.